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As I See

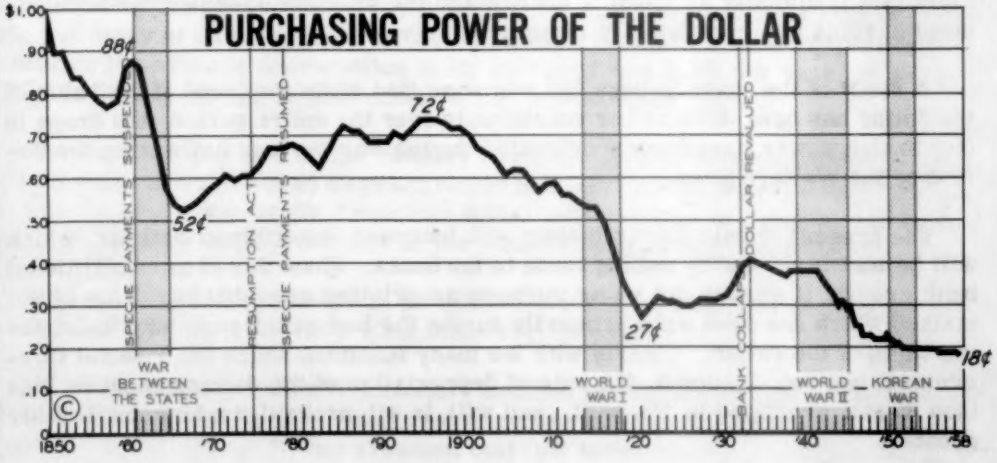
THE MIDDLE EAST AND REAL ESTATE

THE value of the United States dollar has been declining at an average rate of 2% a year since 1850, a period of 108 years. During the last 10 years the rate of decline has been slightly greater, 2.2% per year. Since 1939 the decline has been 53%, or an average of 2.7% per year. Since 1941 the decline has been 51%, or 3% per year.

The chart at the bottom of the page shows the purchasing power of the dollar from 1850 to the present, considering the purchasing power of a dollar to be 100¢ in 1850. On this basis the dollar today will buy 18¢ worth.

During the greater part of these 108 years the trend has been definitely down. For two periods, however, the purchasing power of the dollar increased, once during the big depression of the 1870's, and again from 1920 to 1934.

During 70 of the 108 years the United States dollar was convertible into gold at the rate of $20.67 per ounce. A convertible coinage offers some protection. In 38 of the 108 years the purchasing power of the dollar depended entirely on



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the integrity of the United States Government, as during these years the dollar could not be freely converted into gold. Since 1933 the dollar has not been convertible into gold.

A nonconvertible coinage always offers a tremendous temptation to government, as it makes it possible to finance projects which the public wants, but for which it is not willing to pay in taxes.

A bond was described the other day by Franz Pick in a talk before the New York Society of Security Analysts, as "a certificate of guaranteed confiscation." This has been pointed out in our reports from time to time, particularly in relation to Government "E" bonds. On page 15 of the Real Estate Analyst, published on January 1, 1958, we showed the amount of purchasing power which could be received at any time during a period of 17 years by selling an "E" bond purchased in 1941. This amount included the accrued interest for the time that the bond was held.

At no time during the 17-year period could the purchaser have secured the amount of purchasing power paid originally for the bond. At one time, in the latter part of 1947 and in the early part of 1948, he would have received 30% less in purchasing power than he originally paid. At the present time he would receive approximately 20% less than the amount paid. In other words, this buyer of Government bonds paid the Federal Government approximately 20% to use his money for 17 years, or approximately 1.15% per year. To make matters worse, when he sells these bonds the accrued interest he supposedly secures is counted as income on which he must pay an income tax.

While the illustration we used in the Real Estate Analyst was an "E" bond, the same principle would apply to savings accounts in banks, deposits with savings and loan associations, insurance policies, annuities, mortgages, or any other fixed dollar obligations. Inflation always robs the creditor, but does it so slyly that frequently he doesn't understand the process by which his accumulated savings are consistently diminished in value.

A study of the chart on page 299 will show that while the trend of the value of the dollar has been down rather consistently over the entire period, the drops in purchasing power have been accelerated during war periods and during the period of the Welfare State.

The present Middle East situation will increase Government deficits, which will be met in the end by selling bonds to the banks. Since this creates additional bank credit, it serves the same purpose as printing greenbacks. This is the method which has been used primarily during the last quarter century to debase the value of the dollar. Clearly with the many functions which the Federal Government has now assumed, the rate of depreciation of the dollar cannot be less than it has averaged in the past, and will in all probability be considerably greater.

The tendency of any government to spend money for projects which the public wants, but which it is not willing to support by taxation heavy enough to meet their cost, has always been so great that the values of practically all currencies at all times in the history of the world have progressively declined. This was true in Egypt, Persia, Greece, and Rome. It was true during the Middle Ages. Within modern times, inflations have wiped out the entire value of the currencies of France three times, of Germany once, and have deteriorated the value of the money in all other countries. The June issue of the First National City Bank "Monthly Letter" showed a table of 24 countries ranked on the basis of the integrity of the buying power of their currency for the 10-year period from 1947 to 1957. A summary of this table is shown below.

Country	Annual Rate of Depreciation	Country	Annual Rate of Depreciation
Switzerland	1.2%	Sweden	4.2%
Germany	1.5	United Kingdom	4.7
Venezuela	1.5	New Zealand	4.8
United States	2.2	France	6.2
India	2.3	Mexico	6.9
Belgium	2.6	Uruguay	7.3
Italy	3.0	Australia	7.5
Canada	3.5	Finland	8.9
Denmark	3.6	Peru	9.5
Norway	4.0	Brazil	12.1
South Africa	4.0	Argentina	16.5
Netherlands	4.1	Chile	25.5

It will be noticed that on this table Switzerland has had the lowest rate of depreciation in the value of its money, but even in Switzerland, a country which has avoided all wars, its money has declined at an average rate of 1.2% per year. During the past 10 years the United States has been relatively high on the list, but many of our neighbors to the south have not had the same experience. In Mexico the average depreciation in its currency was 6.9% per year, in Peru 9.5%, in Brazil 12.1%, in Argentina 16.5%, and in Chile 25.5%.

The fact that not one single country has been able to maintain the value of its currency during the past 10 years would indicate that the wise investor must assume that the value of the American dollar will continue to decline, and that dollar obligations will be inferior to the ownership of useful tangibles.

If any stronger argument can be advanced for the ownership of equities in good real estate, I do not know what these arguments can be.

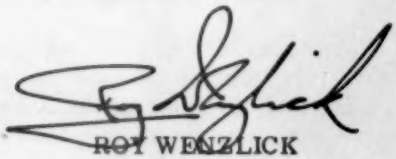
In the same study in the Real Estate Analyst in January of this year an investment in a typical single-family residence was compared with the investment in an "E" bond. Again it was assumed that this investment was made in 1941,

and that all cash was paid for the property. In contrast with the unfavorable experience in "E" bonds, there have been only 8 months in the 17 years when the house could not have been sold for more purchasing power than was originally spent for it. If it had been sold at the beginning of 1958, it would have yielded 53% more purchasing power than was put into it, or an average increase in the purchasing power of 3.1% per year. This does not take into consideration the income which could have been secured from this building by renting it during the 17-year period.

A great deal has been written about the value of real estate in accumulating wealth, and one man attempted to build an entire system of economics on what has been called the "unearned increment," or the increase in value of real estate due to increasing population.

I believe that real estate has been among the best of all investments during a long period of years, but I do not think that the fundamental reason this has been true has been that increasing population pressures have increased value, providing the so-called unearned increment. I think the fundamental reason it has been true in the average community is that real estate is a long-lived article, that replacement costs have increased in dollars as the value of the dollar decreased in purchasing power, and that all existing useful properties have tended to take on at least a part of the increase in their replacement cost new. As replacement costs have gone up, the values of existing properties have risen, and in contrast to bonds and fixed dollar investments, real estate has not only paid a current return but has appreciated in dollars at a slightly faster rate than the value of the dollar has dropped.

In a short-lived article, depreciation reduces the capital value so rapidly that unless increases in replacement cost are very great, depreciation exceeds the increases in replacement cost, and these items do not conserve purchasing power. Since the life of a well-constructed building is considerably in excess of 50 years, depreciation is so slow in relationship to changes in replacement cost that historically this type of investment has proved to be the best inflation hedge.



ROY WENZLICK